**WOOD**

**V.**

**ODESSA WATERWORKS COMPANY**

CHANCERY DIVISION (HIGH COURT)

7TH, 18TH, 22ND, JUNE 1889

**LEX (1889) – 42 CHD 636**

OTHER CITATIONS

2PLR/1889/3 (HL-E)

(1889) 42 CHD 636

[1889 W. 1771.]

**BEFORE:** STIRLING, J.

**BETWEEN**

WOOD – Appellant

AND

ODESSA WATERWORKS COMPANY – Respondent

**REPRESENTATION**

BUCKLEY, Q.C., and F. B. PALMER, for the Motion

HASTINGS, Q.C., and KIRBY, for the Company

Solicitors:

TURNER & HACON;

SLAUGHTER & MAY.

**ISSUES FROM THE CAUSE(S) OF ACTION**

COMPANY LAW: Public Company - Profits earned applied to extension of Works - Bonds bearing nterest given in payment of Dividend - Construction of Articles of Association - Ultrà vires.

**CASE SUMMARY**

HISTORY AND FACT SUMMARY

Facts The articles empowered the directors with the approval of the general meeting to declare 'a dividend to be paid to the members'. The directors recommended that instead of paying a dividend, members should be given, debenture-bonds bearing interest repayable at par, by annual drawings, extending over 30 years. The recommendation was approved by the company in general meeting by an ordinary resolution. The plaintiff successfully sought an injunction restraining the company from acting on the resolution on the ground that it breached the articles.

MOTION that the Defendant company (limited), their directors and agents, might be restrained until the hearing of the action, or further order, from acting on a certain resolution passed at the general meeting of the company held on the 24th of April, 1889, for the payment of dividends on the A shares in the capital of the company by the distribution of bonds of the company, and from issuing any bonds of the company by way of dividends. The Odessa Waterworks Company was formed under the Companies Act of 1862 (25 & 26 Vict. c. 89) as a company limited by shares, with a capital of £850,000, divided into 42,500 shares of £20 each, of which 30,000 were A preferred shares, and 12,500 were B deferred shares. All the A preferred shares, and 12,420 of the B deferred shares were actually issued, and had been fully paid up. For some years past the company had not paid any dividends, but the accounts of the company shewed an excess of receipts over expenditure to the amount of £45,959 4s. 6d., which, it was said, was now available for payment of a dividend. That sum did not exist in the shape of cash in the coffers of the company, but had been applied in extending the company's mains, and in the construction of other productive works, being purposes for which the capital of the company was applicable.

Under those circumstances the directors issued a report dated the 10th of April, 1889, in which they set out a series of resolutions, adopted by the board, to the effect following:-

That the directors had resolved to raise, by way of further charge on the property and assets of the company, the sum of £100,000, and that £30,000 of such second charge should be allocated by way of dividend of £1 per share, free of income tax, on the A preferred shares; that the said £30,000 should be divided into bonds of £50 each, and bonds of £100 each, with coupons attached, bearing interest at £5 per cent. per annum, payable half-yearly, with a provision for the repayment of the bonds at par, by annual drawings, extending over thirty years; and that so many of the said bonds as might be necessary for the purpose should be issued direct to those shareholders whose dividends at £1 per share amounted to £50 and upwards. Then followed provisions as to the mode of application and payment of the proposed dividend to shareholders whose dividends did not amount to £50. The directors further recommended the payment of a dividend of £1 per share, free of income tax, in respect of the A shares, such dividend to be distributed in the mode provided by the resolution of the board applicable thereto. Along with the report, notice was given that the ordinary meeting of the company would be held on the 24th of April, 1889, to receive the report; to declare a dividend; and to transact the ordinary business of the company. The meeting was accordingly held, and a resolution was passed:- "That the report of the directors, and the accounts submitted therewith be, and the same are hereby adopted, and that a dividend of £1 per share on the A shares of the company be, and the same is hereby sanctioned, free of income tax, in accordance with the report of the directors." The Plaintiff, who was the holder of 355 A shares and 50 B shares, was not present at the meeting, but upon being informed of what had been done, expressed to the officers of the company his objections to the resolution. On the 4th of June, 1889, he received a circular offering him debentures in accordance with the resolution, and thereupon he, on behalf of himself and all other the shareholders in the company, brought this action for an injunction to restrain the company from acting on the resolution to which he objected, on the ground that it contravened the articles of association of the company. Those articles were, so far as material, as follows:-

"Dividends.

"101. The directors may, with the sanction of the company at the ordinary general meeting, declare a dividend to be paid to the members in proportion to their shares, subject, however, to the provision contained in article 105 of these presents, and the next succeeding article.

"102. No dividend shall however be declared to be paid to the proprietors of B deferred shares, unless and until the net profits of the company for the current year shall have enabled the directors to declare and pay to the proprietors of A deferred shares a preferential dividend after the rate of £6 per cent. per annum for that year. And after the proprietors of B deferred shares shall have been paid a dividend equal to £6 per cent. per annum for the same current year, the residue, if any, shall, subject to the provisions contained in article 105, be equally divided between both classes of shareholders pari passu, in proportion to the amounts called and paid upon their respective shares.

"103. They may also as, and when they think fit, pay to the members half-yearly an interim dividend in advance or on account of any yearly dividend estimated by them to be payable to the shareholders in respect of the net profits of the company during that current year, subject, however, to the provisions hereinafter contained with respect to the reserve and sinking funds respectively.

"104. No dividend shall be declared or payable except out of the profits arising from the business of the company, and no unpaid dividend or interest shall ever bear interest as against the company.

"105. The directors may set aside out of the profits or receipts of the company such sum as they may think proper to a fund to form a 'sinking fund' for the redemption of capital, or to a fund to be called 'the contingency fund,' for the purpose of meeting any unforeseen or prospective liabilities, and may, further, out of the said profits set aside such sum as they may think proper as a reserve fund for equalizing dividends or for any other purposes of the company; and the directors may invest the sums so set apart upon such securities as they may select, except in the purchase of the shares of the company."

ISSUES FOR DETERMINATION WITH ARGUMENTS OF COUNSEL(S)

Buckley, Q.C., and F. B. Palmer, for the motion:-

No dividend has been paid upon the shares in this company up to the present time. The language of the articles of association in reference to the declaration and payment of dividends is quite plain. The meaning of it is that the directors are to pay them. In the ordinary sense of the word "pay" they are to hand over a sum of money to each shareholder. The proposal of the directors is inconsistent with the articles of association, and the articles alone are what the Court has to consider: Oakbank Oil Company v. Crum (1). The directors propose to give bonds with a right to be paid off by an annual drawing, and a right to interest until paid off, and that is directly contrary to art. 104. It is for the Court to declare how the profits arising from the undertaking shall be divided. The declaration that bonds shall be given instead of dividing the profits is ultrà vires. There was no contract with the shareholders to pay them a dividend in shares or bonds, and the shareholders have a right to say that they are entitled to be paid their proportion of the profits, and to refuse to have issued to them bonds, as a dividend, for the nominal value of £100, which as alleged, are worth only £90 in the market. The proposal of the directors may be said to be a compulsory loan by way of declaration of a dividend at present, but payable at an uncertain period in the future. The facts in the case of Hoole v. Great Western Railway Company (2) are different from those here, but the doctrine laid down in that case is applicable to this. The Plaintiff confidently asks for an order to prevent the resolution being carried into effect; the scheme proposed being quite inconsistent with the articles of association.

Hastings, Q.C., and Kirby, for the company:-

The proposal of the directors if carried out will be a payment of a dividend, but, no doubt, it will be postponed.

The case of Hoole v. Great Western Railway Company (1) is very different from this, and does not affect it at all, as the company here propose to give an acknowledgment of indebtedness to the shareholders which will enable them to receive their moneys, though it may be subject to the liability of allowing a small discount. The bonds will, there can be no doubt, be negotiable instruments should any shareholder want his money, but if he can wait until the company can pay him off he will receive the full amount, with interest. The proposed method of payment by the directors is the only one by which they can secure to the shareholders for the time being the profits which have been realized.

(1) 8 App. Cas. 65.; (2) Law Rep. 3 Ch. 262.

[STIRLING, J.:- The directors are compelling the shareholders to make a forced loan, as the dividend bonds are not payable immediately, but at an uncertain time.]

There is nothing illegal in what the directors propose to do. The company have earned the profits, but their position is such that they cannot pay them in a dividend now, having sunk them in executing new works, which will no doubt be of great advantage to the company in the future. The Plaintiff asks in effect that the company shall not declare a dividend now, simply because they are not able to pay in cash; but the company have power to declare a dividend out of the profits which have been earned. The shareholders are entitled to the profits - the result of the year's operations - and they ought not to be deprived of them at the instance of the Plaintiff simply because the company have not got the moneys in their coffers. There is nothing in the proposal of the directors which will bear more hardly upon one shareholder than upon another. There is nothing contrary either to the law or to anything contained in the Act of Parliament, and the proposal is not prohibited by the articles of association. The company have power to borrow moneys, but it was convenient, instead of doing so, to apply the profits towards the construction of new works, and thus prevent the necessity of borrowing. Such a proposal is for the benefit of the shareholders. The case of Oakbank Oil Company v. Crum (2). is quite in point, as here there are profits, but not in the coffers of the company, having been expended in new works. The motion ought to be refused.

(1) Law Rep. 3 Ch. 262.; (2) 8 App. Cas. 65.

Buckley, in reply.

**MAIN JUDGMENT**

1889. June 22.

STIRLING, J. (AFTER STATING THE FACTS SET FORTH ABOVE, CONTINUED):-

Before going further I think it is desirable that I should indicate the precise point which I have to decide. It was not disputed that profits available for the payment of a dividend by the company had been actually earned. I have not, therefore, to deal with any of the questions which formed the subject of decision or discussion in the recent case of Lee v. Neuchatel Asphalte Company (1). Neither was it disputed that the company had power to create a charge on the assets of the company, or to raise money by means of such charge, or to apply the money so raised in payment of a dividend. The question, simply, is whether it is within the power of a majority of the shareholders to insist against the will of a minority that the profits which have been actually earned shall be divided, not by the payment of cash, but by the issue of debenture-bonds of the company bearing interest at £5 per cent. and repayable at par by an annual drawing extending over thirty years. It is to be inferred from the terms in which the bonds are offered for subscription that the company cannot issue them in the open market except at a discount of at least £10 per cent. Now the rights of the shareholders in respect of a division of the profits of the company are governed by the provisions in the articles of association. By sect. 16 of the Companies Act, 1862 (25 & 26 Vict. c. 89), the articles of association "bind the company and the members thereof to the same extent as if each member had subscribed his name and affixed his seal thereto, and there were in such articles contained a covenant on the part of himself, his heirs, executors, and administrators, to conform to all the regulations contained in such articles, subject to the provisions of this Act."

(1) 41 Ch. D. 1.

Sect. 50 of the Act provides the means for altering the regulations of the company contained in the articles of association by passing a special resolution, but no such resolution has in this case been passed or attempted to be passed; and the question is, whether this is a matter as to which the majority of the shareholders can bind those shareholders who dissent. The articles of association constitute a contract not merely between the shareholders and the company, but between each individual shareholder and every other; and the question which I have just stated must, in my opinion, be answered in the negative if there be in the articles a contract between the shareholders as to a division of profits, and the provisions of that contract have not been followed. That appears to have been distinctly laid down with reference to the very matter in question by the Earl of Selborne in the case of the Oakbank Oil Company v. Crum (1). where his Lordship said(2):- "It appears to me that directors and general meetings of companies of this sort can have no powers by implication except such as are incident to, or properly to be inferred from, the powers expressed in the memorandum and articles of association. Their powers are entirely created by the law and by the contract founded upon the law which enables such companies to be constituted. Therefore I think the word 'may' means, that if the directors get the assent of a general meeting they may declare a dividend; but that is not to be any kind of dividend, it is to be a dividend of that kind which the clause contemplates." That then brings me to consider whether that which is proposed to be done in the present case is in accordance with the articles of association of the company. Those articles provide (101) that the directors may, with the sanction of a general meeting, declare a dividend to be paid to the shareholders. Primâ facie that means to be paid in cash. The debenture-bonds proposed to be issued are not payments in cash; they are merely agreements or promises to pay: and if the contention of the company prevails a shareholder will be compelled to accept in lieu of cash a debt of the company payable at some uncertain future period. In my opinion that contention ought not to prevail unless there be a context which shews that which I have said is the primâ facie meaning of art. 101 is not the true meaning, otherwise the shareholders will be deprived of the right to which everyone is entitled under our law of disclaiming or refusing acceptance of every species of property not being property cast upon him by operation of law. The context, so far from being in favour of the Defendants' contention, appears to me to be decidedly against it. Art. 102 speaks throughout of dividends "to be paid" to the shareholders, and art. 104 provides that no unpaid dividend or interest shall bear interest against the company. It was said that that is merely a stipulation inserted in favour of the company and for the purpose of preventing shareholders from claiming as against the company interest on dividends. That argument appears to me to overlook what I have already pointed out, that the articles constitute an agreement between the shareholders inter se; but even if it were well founded the stipulation tends strongly to support the primâ facie meaning of art. 101.

(1) 8 App. Cas. 65.; (2) 8 App. Cas. 71.

This view appears to me to be in accordance with that which was laid down by the Court of Appeal, at that time consisting of Lord Cairns and Lord Justice Rolt, in Hoole v. Great Western Railway Company (1). That case is, no doubt, not in all its features precisely similar to the present. It turned on the construction of an Act of Parliament, the language of which differs somewhat, though not, I think, materially, from that of the articles of association with which I have to deal. The property proposed to be divided among the shareholders consisted not of debenture-bonds, but of shares in the company, and those shares were to be issued at a discount. The decision of the Court of Appeal, however, was not, as I read it, rested on any of these distinguishing circumstances. Lord Cairns said(2): "Now, as regards the arrangement that is proposed, there are a certain number of persons whom it suits to increase their stake in the company, and to take shares; there are certain other persons (and it may be, the plaintiff is one) who do not wish to take shares, but wish to get whatever they are entitled to in the shape of money. If what was proposed was, that every shareholder should have an option to take shares at a certain price, or if he did not like that, to take his money, that (subject to the question I have passed from, as to allotting shares at a discount) would appear to be a perfectly equal arrangement, under which any person who chose might take the shares, and anyone who declined might receive his dividend in money, so that no complaint could be made on the ground of unfairness. But the offer made is substantially this - you, shareholder A., must either take this £100 share as worth £100, although it is not worth so much, or you must wait for that indefinite period mentioned in the report, at which it is expected there will be money to pay the shareholders in cash. There, again, as it appears to me, the company are involved in a dilemma; either these shares are assets available for the purpose of paying the dividend, or they are not. If they are not assets available for the payment of the dividend, they cannot be issued for the purpose of such payment. If, on the other hand, they are assets for that purpose, and the whole of the shareholders are not willing to take them in specie, it appears to me that every shareholder in the company who is so inclined has the clearest right to have them turned into money and to have the money rateably divided among the shareholders. If it be said in answer, that the assets cannot be turned into money because they are not at present saleable except at a discount, but will hereafter be saleable at their full value, then the rejoinder is that every shareholder has a right to say they shall be kept until the time arrives when they will be saleable at their proper value.

(1) Law Rep. 3 Ch. 262.; (2) Law Rep. 3 Ch. 271.

It appears to me that it is impossible to escape from the conclusion that, if saleable, they must be sold for the equal benefit of all, and if not saleable must be kept for the equal benefit of all." And Lord Justice Rolt said(1): "What the directors do allege is this: that in the course of the current half-year in which the profits were being made, and while they were being made, they spent some of what they call their revenue in satisfying capital purposes, and then when they came at the end of the half-year to declare the dividend, they proposed to ascertain the profit without deducting that money which, during the currency of the half-year, they had expended for capital purposes. That is a very different question; and even if the case had been, that, as to the shares they were about to issue, they proposed to have the calls paid by the public to whom they were to be issued, and to appropriate the money to make good the sums which they had expended for capital purposes during the currency of the half-year, I should very much doubt whether that would have been a lawful appropriation of the money raised by the shares. But they do not propose to sell the shares, they propose instead to offer the option of these shares to the shareholders, who, it is said, are entitled to a dividend, and to let them take these shares at par if they think fit so to do, and leave the other shareholders to wait the opportunity of being able to settle their claims." And further on his Lordship said: "I give no opinion upon the question whether the shares could be issued to be sold at a discount; but, supposing they could, this further question arises, whether the company, instead of selling the shares and dividing the money rateably among the shareholders towards payment of their dividends, could offer the shares to those shareholders who liked to take them at their full nominal amount in satisfaction of their dividends. I am of opinion that such a proceeding was illegal, and not an arrangement as to which the majority could bind the minority... I think(1) that under a direction to apportion, appropriate, and pay the net revenues amongst all the shareholders rateably, the offering to the shareholders in lieu of the dividend shares which some shareholders will take and others will not take, is entirely beyond the power of the company; and that anyone who declines to accept them may say: 'This is not a payment within the meaning of the Act; you are not proposing to pay anybody; you are, indeed, proposing to give a thing that may be sold in the market, but you are not proposing to give that which we are bound to take, you give us an option to take it, to some of us it may be beneficial to accept the option, to others it may not be so; the offering such an option is not a payment of the apportioned share of net profits, and is beyond your power - we decline to accept it, and we ask the Court to interfere to prevent its being offered to others.'"

(1) Law Rep. 3 Ch. 276.

Mutatis mutandis these remarks seem to apply to the issue of the debenture-bonds of the Defendant company. It was said that nothing could be more reasonable than that this company should be able to pay dividends in the manner proposed, or by the division in specie of assets of the company, e.g., fully paid-up shares in another company held by the Defendant company. With those considerations, however, I have nothing to do. They might properly have been weighed by the framers of the articles of association: they may possibly be fit to be submitted to the shareholders of this company, if and when they are invited to consider the propriety of altering the regulations of the company under sect. 50 of the Companies Act, 1862. What I have to determine is, whether that which is proposed to be done is in accordance with the articles of association as they stand, and, in my judgment, it is not, and therefore the Plaintiff is entitled to an injunction so far as relates to the payment of dividends until the hearing of the action, or further order, and the costs of the motion will be costs in the action.

(1) Law Rep. 3 Ch. 277.

Section 41(3) of CAMA now provides that a power conferred by the articles on an outsider enabling him to appoint a director is enforceable.